



1997 Annual Report

Federal Prison Industries

Public Program Private Benefit

OEI

CoreConcepts

uvex®

**CAROL
BRAND**

TAMSCO®

**HOWARD
INDUSTRIES**
Architectural Signage Systems

LM

CDI



U.S. SAFETY

Nightingale Inc.

CONCEPT

COLUMBIA
Business Furniture

MISSION STATEMENT

It is the mission of Federal Prison Industries to employ and provide skills training to the greatest practicable number of inmates in federal correctional facilities necessary to ensure the safe and secure operation of such institutions, and in doing so, to produce market priced, quality goods in a self-sustaining manner that minimizes potential impact on private business and labor.

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ABOUT THE COVER

This Annual Report highlights the important relationship between Federal Prison Industries (FPI) and its private sector vendors/partners. Reflected on the cover are logos from selected FPI vendors/partners.

Fiscal Year At A Glance

OPERATIONS HIGHLIGHTS

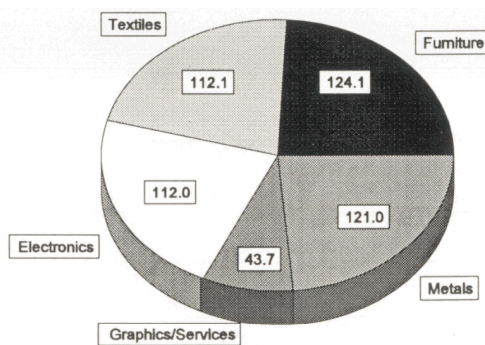
(in millions of dollars)	1996	1997
Net Sales	\$495.5	\$512.8
Gross Profit	\$ 48.2	\$ 48.4
Net Income	\$ 12.1	\$ 3.1
Cash Paid to Suppliers	\$379.4	\$384.6
Inmates Employed	17,379	18,414

NET SALES

INMATE EMPLOYMENT

SALES BY PROGRAM

(dollars in millions)





Attorney General Janet Reno

Foreword from the Attorney General

Our Nation's efforts to maintain an effective system of law enforcement do not end when a person is arrested, convicted of a crime, and sentenced. Our system of law enforcement also includes the period of time when the offender serves a sentence in a correctional institution. The Federal Bureau of Prisons (Bureau), a component agency of the Department of Justice, is charged with the important responsibility of keeping the public safe by confining sentenced federal offenders in institutions that are safe, secure and humane. Successful management of our Nation's federal correctional institutions is also contingent upon other components and resources to accomplish the Bureau's mission. Federal Prison Industries, Inc. (FPI) is a component within the Bureau that makes a daily contribution to the safe and orderly operation of our federal prison system.

FPI is an essential correctional program that supports the Bureau's law enforcement efforts by providing federal inmates with job training and useful employment opportunities in diversified work programs. Since FPI does not receive appropriated funds from Congress, its mission is to remain a self-sustaining correctional program by producing market priced, quality goods and services for sale to the Federal Government. This mission is accomplished without placing additional expenses on American taxpayers and by minimizing competition with the private sector.

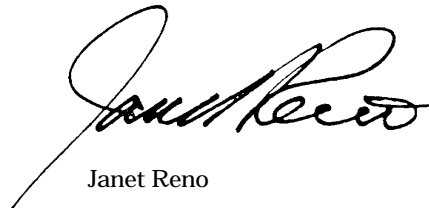
The Bureau's mission is made increasingly difficult by the relentless growth in

the federal inmate population. Further increasing the current inmate population projections, shortly after the turn of this century, all sentenced felons in the District of Columbia Department of Corrections will be transferred to the jurisdiction of the federal prison system. Consequently, the Bureau and FPI will face even more complex challenges during future years. Inmate population growth compels FPI to explore new alternatives for inmate employment. These alternatives must generate a self-sustaining source of work for federal inmates while addressing legitimate concerns from private sector businesses and organized labor.

Not only does FPI play a vital role within the Bureau, it also provides benefits to society. Inmates who work in FPI have improved chances for viable employment and a crime-free lifestyle upon release. Thus, FPI promotes public safety in our communities and reduces public assistance costs.

Further, through its business partnerships with the private sector, FPI provides financial benefits to our Nation's local communities from (a) FPI purchases of raw materials, services, supplies, and equipment, (b) staff salaries that are disbursed from FPI's payroll, and (c) the collection of fines, child support, and victim restitution from inmates.

In summary, FPI's continued success is a vital element of our Nation's law enforcement efforts, and an important part of our economy. It is performing as the American public expects, and it deserves our continued support.



Janet Reno

Message to the United States Congress from the Board of Directors

The Board of Directors of FPI is pleased to present the Fiscal Year 1997 Annual Report to the Congress of the United States. FPI was established by an act of Congress on June 23, 1934, to provide job skills training and useful employment opportunities for inmates confined in the Bureau. For more than 63 years, FPI has accomplished its mission to function as a successful correctional program by operating in a self-sustaining manner to produce quality goods and services for Federal Government agencies. FPI is mindful to diversify its production of products and services and to administer its industrial operations in such a manner that reduces competition with private sector businesses.

A. Background

The Presidentially-appointed Board members are selected to govern FPI's operations and advance its mission by establishing general policies and long range corporate plans, and approving new factories. Commissioned to serve without compensation, the Board uses its diverse background experience in business, government, and industry to achieve FPI's statutory mandates. Since the majority of FPI's Board members are employed in private sector positions, the Board is obliged to remain sensitive and impartial during its decision making process regarding concerns and issues expressed by the private sector. This obligation means that the Board must acknowledge the concerns and interests of a vast segment of private sector groups ranging from professional trade associations, business corporations, and various manufacturers to organized labor groups, local and state governing officials, and individual private citizens. The Board must create and adhere to policies that will successfully guide FPI on a course that will maintain its self-sustaining mode of operation. When establishing FPI's production levels, the Board's guidance must also ensure that these levels minimize any negative impact on private industry and labor.

FPI provides job training and employment opportunities as a realistic approach to (a) circumvent prison management problems, (b) bestow work ethics and other self-improvement attributes in inmates, (c) reduce the cost of

incarceration, (d) motivate inmates to forsake criminal behavior and become employed ex-offenders who can merge their way back into our communities as productive citizens, and (e) provide benefits to our communities by reducing the recidivism rate and increasing public safety.

FPI's realistic approach to training and employing inmates is documented and rated as a proven method for reducing the threatening effects of recidivism on our communities. The positive benefits of FPI's mission are highlighted and summarized in the Post Release Employment Project (PREP) study. PREP is a research study conducted by the Bureau to analyze and assess the impact of prison vocational training and FPI work experience acquired by federal inmates. Starting in 1983, the employment patterns of more than 7,000 ex-offenders were documented to measure the effects of their prison vocational training and FPI work experience after their release from incarceration. After seven years of research, the PREP Study substantiated that FPI's training programs significantly decreased inmate recidivism rates and increased job-related success for ex-offenders in the free world job market.

During Fiscal Year 1996, further PREP Study research was conducted and updated. Most notably, the updated data show that federal inmates who participated in prison industries or vocational training programs had a survival rate (time spent in the community before reincarceration) that was at least 20 percent greater than similar inmates who did not participate in such programs. Once again, the research results confirmed the positive impact of FPI programs on the successful transformation of an ex-offender's lifestyle, as evidenced in many ex-offenders who develop the tendency to avoid criminal behavior after returning to the "free world."

B. Contrasting Criteria

FPI cannot operate like a private sector business, because it is a correctional program. Since prison industry programs must train and employ as many inmates as feasible, FPI does not

*“Our partnering with FPI has provided the federal customer access to a
wide array of quality seating”*
Nightingale Inc.

reap the many advantages and benefits which private sector businesses are afforded. By drawing a comparison between FPI’s correctional programs and the operations of private sector businesses, the following distinct contrasts exist:

- **Work Environment:** In contrast to private industry work environments, FPI must cope with and endure work force obstacles and disruptions that are often absent in factories and plants operated by the private sector. Unlike the freedom of movement among employees in private sector plants and factories, FPI must constantly monitor inmate movements to maintain order and security. Tools and equipment used by inmates require periodic surveillance throughout each inmate’s work cycle.
- **Job Skills:** In contrast to the work experience of private sector employees, most FPI inmates have acquired little, if any, prior job skills or work experience before working in prison industry programs.
- **Procedure for Creating a Workforce:** The private sector business community selects the size of its own work force. In contrast, the size of FPI’s work force is not selected by FPI. Among other criteria, sentencing guidelines help to determine the Bureau’s inmate population levels. In turn, FPI must hire a percentage of the “pre-established” Bureau inmate population.
- **Work Intensity:** In contrast to the automation, technology, and equipment used for rapid production in private sector shops, factories and plants, FPI must use labor-intensive methods of operation to keep the largest possible number of inmates in productive work programs.
- **Sales Market:** In contrast to the vast sales markets available to private sector businesses, FPI is prohibited from selling its manufactured products to the private sector. FPI can only rely on the sale of its products to federal agencies.
- **Profit Goals:** In contrast to most private sector businesses, FPI does not operate to

accumulate a normal financial profit or return on investment.

C. Operational Strategies and Policies

There is no great debate concerning whether inmates should work. Public sentiment generally endorses a work environment for inmates versus an environment of idleness and non-productivity that can stimulate stress and unrest in an inmate’s mind. Continued dramatic growth of the federal inmate population increases the need to build new correctional institutions -- physical space to accommodate population growth patterns.

1. Factory Activations

Addressing the challenge to create more space to house more inmates extends to the activation of new factory locations throughout our Nation to keep inmates productively occupied in work programs. During Fiscal Year 1997, FPI opened five new factories to strengthen the Bureau’s ability to successfully manage federal inmates.

All new construction projects require the expenditure of vast financial resources to plan, build, and operate each new FPI factory. Local communities and private sector businesses experience the economic advantage of their geographical proximity to an FPI factory location. The construction of FPI factories, from beginning to end, is possible only with the purchases of numerous raw materials, services, equipment, and supplies from local suppliers within the private sector business communities. To successfully activate new factories, FPI must:

- hire private sector contractors to design and build FPI factory complexes; in turn, these contractors hire private sector subcontractors who also benefit from factory construction;
- purchase raw materials and finished goods from numerous private sector distributors;
- make regular payments for the daily use of utility services and communication lines;

“Working with Federal Prison Industries provides total customer satisfaction in services that include design layout, space planning, installation and project management.”

Core Concepts

- hire law-abiding citizens from the surrounding local communities to work as staff employees who train and supervise FPI inmates;
- establish contract agreements with local businesses to lease or purchase equipment and machinery for use in FPI business offices and factories; and,
- pay local private sector businesses to perform major building maintenance and structural repairs.

All phases of activation signify how the entire birth process of each FPI factory automatically serves the public by pumping revenue into the local economy and making the private sector a lucrative partner with the Federal Government.

2. Inmate Financial Restitution to Society and Expenditures

The Bureau and FPI make every concerted effort to expose federal inmates to self-improvement opportunities. Abandoning criminal behavior means an inmate must adopt ethical values. These ethical values are necessary to convert inmates into habitual abiders of the law. The acceptance of financial responsibility is one such ethical value that inmates should adopt as they learn how to honor and respect the law. Through the Inmate Financial Responsibility Program, the Bureau established a policy to promote a sense of responsibility in inmates. Under this program, all inmates who earn a stipend from employment must repay society through restitution for certain legal obligations and losses incurred from their misconduct.



Inmates repairing remanufactured engine for shipment.

“Our relationship with Federal Prison Industries complements our overall business and affords us the opportunity to better serve both prison industries as well as the private sector.”

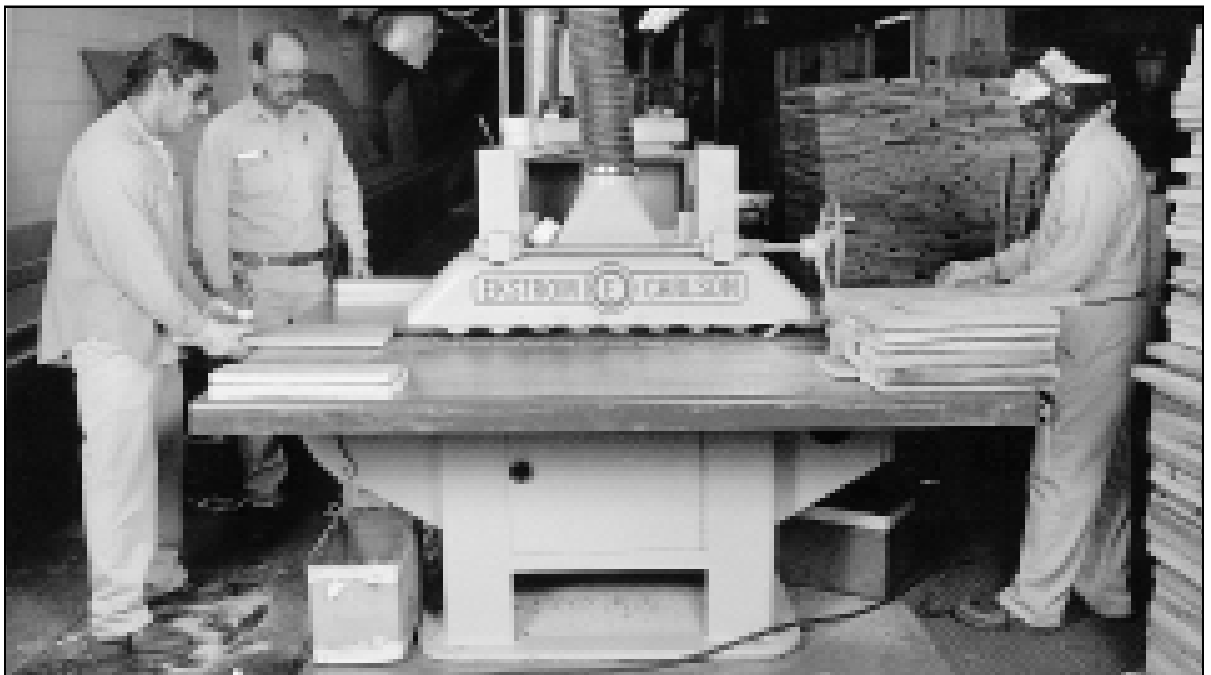
Concept Fabrics, Inc.

Basic pay rates for inmates working in FPI programs range from \$.23 to \$1.15 per hour. Under the Inmate Financial Responsibility Program, FPI inmates must contribute at least 50 percent of their FPI earnings to pay (a) domestic obligations such as family support, (b) court-ordered fines, and (c) restitution to victimized citizens. During Fiscal Year 1997, the Bureau deposited over \$1.8 million from FPI inmate wages into the Inmate Financial Responsibility Program. Since the Bureau deposits a significant portion of FPI inmate wages into this reserve financial program, American taxpayers are relieved from paying certain expenses that are the consequences of criminal behavior.

Additionally, inmates also use their FPI

pay to purchase miscellaneous personal items from vending machines and commissaries that are stocked by local private sector vendors. Thus, other portions of FPI inmate wages are eventually funneled back into the mainstream of our Nation's economy.

When inmates reimburse society for their criminal behavior, and spend portions of their earnings from FPI employment during their incarceration, the positive financial benefits provided to society and private sector businesses are often ambiguous or totally obscured from public comprehension and acknowledgment. Nevertheless, this underlying source of financial support is always manifested and reflected in the economic profits derived by private businesses.



Senior Foreman, Brad Sowter, supervising the straight line rip saw operation.

“Our partnership with UNICOR is an excellent example of how the public and private sectors can work together towards mutually beneficial goals.”

U.S. Safety

3. Waiver Process: Granting Options to Procure from Private Sector Businesses

Since FPI is prohibited from competing for sales in the private market, it can only rely on selling its products and services to the Federal Government. Congress legislatively established a mandatory purchasing source for FPI to equalize its market source for sales with that of private industry. When FPI is unable to produce its products to meet customer specifications such as delivery dates or desired quantities, FPI grants a waiver to give potential customers permission to purchase their products from an open market of private sector businesses. Through the waiver process, potential FPI customers have the option of making procurements with private vendors and suppliers.

By deflecting this potential source of sales revenue into the private sector market, FPI disperses business opportunities throughout our national economic structure by forfeiting a portion of the market to private industry. FPI's deflection of sales revenue to private sector vendors and suppliers creates additional work for them, and additional work means that private sector businesses must hire additional workers to meet production demands.

4. Establishing Levels of Production

One of the Board's primary responsibilities is to establish production levels for FPI products by deciding whether FPI will be permitted to manufacture new products or significantly expand the production of its existing products. FPI refers to this decision making process as the Industry Involvement Guidelines (Guidelines) process.

The Board's final decisions to establish and regulate FPI's production levels must be predicated upon FPI's statutory mandate to (a) avoid capturing more than a reasonable share of the market, (b) train and employ inmates to the greatest extent possible to produce goods and services in a self-sustaining manner, and (c) minimize potential impact on private industry. The Board must continually promote FPI's mission to remain a financially self-sufficient

correctional program, while equitably weighing concerns expressed by private industry.

a. New Interim Guidelines Definitions

During Fiscal Year 1997, the definitions for some of the key terms in FPI's Guidelines were revised. The new interim Guidelines definitions were issued to clarify original definitions. Under the new interim definitions, the term "significant expansion" is now based on FPI's sales rather than FPI's production capacity, thus better measuring FPI's potential impact on the private sector.

b. Guidelines Hearings and Board Decisions

The Guidelines process was also formulated to assist the Board in obtaining written and oral comments concerning FPI's proposals to modify its production levels. In accordance with federal statutory law, FPI must issue a public notice concerning its "plans to produce any new product or to significantly expand production of an existing product." Written and oral comments are solicited from private sector entities such as manufacturers, trade associations, organized labor, and other interested parties who have a shared interest in FPI operations. During each public Guidelines hearing, the Board listens to all interested parties who appear in person to express their views and make recommendations regarding FPI's proposals.

Since the Board has a responsibility to render equitable decisions based on comprehensive data, its decision making process entails an in-depth analysis of FPI impact studies that compile and describe the federal and domestic markets for specific products and FPI's proposed market share. The Board examines this compilation of information to decide whether FPI's proposed level of production is a "reasonable" market share of an industry. Also, the Board must decide whether the proposal creates an "undue burden" of competition upon private sector operations. Consequently, the Board considers private industry concerns during

“UNICOR and Columbia are on the cutting edge of new designs and technology, and are opening the door for future partnerships with other suppliers to build better relations with UNICOR and its customers.”

Columbia Business Furniture

each phase of the Guidelines process – to allow equitable access to the sales market for private sector businesses that manufacture products similar to the products manufactured by FPI.

During Fiscal Year 1997, the Board issued decisions for the following proposals developed by FPI: (a) production of aluminum and steel shipping and storage containers as a new product, (b) expansion of office case goods, (c) production of sweatshirts and sweatpants as a new product, and (d) expansion of gloves.

D. Planning: The Transfer of Inmates from the District of Columbia to the Federal Prison System

Along with the forthcoming transfer of all sentenced felons from the District of Columbia Department of Corrections to the federal prison system, massive planning is mandatory to accommodate the arrival of these sentenced felons and carry out a smooth and orderly conversion of jurisdictional authority. This impending expansion of the Bureau's inmate population augments FPI's need to:

- extend its training resources to include a new category of incoming inmates;
- create additional prison industry jobs to keep approximately 25 percent of the Bureau's inmate population productively occupied in employment programs;
- find extra physical space at factory sites to house inmates during their hours of training and employment;
- hire additional training staff;
- seek ways to keep its methods of operation as labor-intensive as possible;

- purchase additional tools, materials, and equipment from private sector businesses to maintain efficient work production levels;
- incur additional expenses for the use of more local utility services;
- increase staffing to maintain a wider range of security and safety; and
- increase administrative staff to handle the logistics of processing additional paperwork, computer transactions, and other forms of documentation associated with correctional training and a work environment.

E. Future Focus

In summary, the Board of Directors is encouraged by FPI's operational efforts to stimulate mutual and lucrative interaction with the private sector. Since prison industry work is a critical component of the federal prison system, the Board envisions a unique outgrowth of opportunities for FPI to involve private sector businesses in its procurement operations. The Board will also focus on discovering new operational strategies to further reduce any perceived competition between FPI and the private sector. This directional change will exemplify FPI's sincere goal to cultivate private sector partnerships from which every segment of society will benefit. These benefits could have the potential to provide a stronger national economic base that extends advantages and benefits to local communities throughout our Nation.

The Board's decision making authority will embrace this future focus and continue to seek new ways to maintain a mutually respectful relationship with Congress.

Federal Prison Industries Board of Directors



Joseph M. Aragon (Chairman) Represents Retailers and Consumers.
Appointed to the Board August 8, 1994.

Mr. Aragon is the President and Chief Executive Officer of ProServe Corporation, an award-winning, growth oriented food service management company founded in 1984. Mr. Aragon currently serves on several civic and charitable boards, and he previously worked in the Federal Government for 12 years. He is a graduate of Florida State University (B.S. in Management, 1978).



Stephen R. Colgate (Member) Represents the Attorney General.
Appointed to the Board August 8, 1994.

Mr. Colgate has been serving as Assistant Attorney General for Administration since 1992. He is a graduate of American University (M.P.A. in Public Finance, 1976) and the University of Arizona (B.S., 1975).



Susan A. Loewenberg (Member) Represents Industry.
Appointed to the Board May 10, 1995.

Ms. Loewenberg has worked in the communications industry since 1974, and is the Producing Director of L.A. Theatre Works, which produces cultural programming in collaboration with the Voice of America, National Public Radio and the British Broadcasting Corporation. Ms. Loewenberg has been involved in correctional issues at the local, state, and federal levels and has been actively involved in developing various innovative communications and educational training programs in federal institutions nationwide, and in the state prison system in California. She currently supervises a program for at-risk-youth in collaboration with the Los Angeles County Board of Education, Special Schools Division for Incarcerated Youngsters. Ms. Loewenberg is a graduate of Sarah Lawrence College.

“As a preferred vendor for over 25 years, we consider FPI a ‘Blue Ribbon Customer’ and we appreciate the opportunity to assist FPI in supplying quality end products to its customers.”

Carol Cable Company



Todd A. Weiler (Member) Represents the Secretary of Defense.
Appointed to the Board March 4, 1996.

Mr. Weiler is the Acting Principal Deputy Assistant Secretary of the Army for Manpower and Reserve Affairs. He has served as the White House Liaison for the Secretary of Defense. Mr. Weiler is the recipient of several Army leadership awards including the Meritorious Service Medal and Air Medals for Merit and Service. He has been instrumental in developing programs in the area of drug demand reduction involving our Nation's youth and is a key leader in defense distance learning initiatives. Mr. Weiler is a graduate of Texas Christian University (B.A., 1987).



Richard G. Womack (Member) Represents Labor.
Appointed to the Board March 4, 1996.

Mr. Womack has been serving as the Director of the AFL-CIO Department of Civil Rights since 1986. In this capacity, he is the primary spokesperson for the AFL-CIO on a broad range of social issues involving worker rights, human rights, and civil rights. Previously, he was the Assistant Director of the AFL-CIO Human Resources Development Institute, and a field coordinator for the AFL-CIO Appalachians Council. Mr. Womack is a member of the NAACP's National Board of Directors, and chairs the NAACP's National Board of Directors' Labor Committee and the Board of the National Coalition on Black Voter Participation. Mr. Womack serves on the Executive Committee of the President's Committee on Employment of People with Disabilities, and he is a national board member of the A. Philip Randolph Institute. He has also served as Acting Executive Director of the Leadership Conference on Civil Rights. Mr. Womack attended Cheyney University in Pennsylvania.

“Utilizing UNICOR’s ability to perform under tight time and schedule constraints to produce high quality line art for technical digitization, we have been able to give the customer the best quality product possible.”

TAMSCO

Message from the Director, Federal Bureau of Prisons and Chief Executive Officer, Federal Prison Industries



Kathleen M. Hawk
Director, Federal Bureau of Prisons

Fiscal Year 1997 can best be summed up by one word: more. More inmates employed, more sales to our customers, more purchases from our vendors, more initiatives to improve our operations. It was also a year of more public debate over how FPI should function and its impact.

More Inmates Employed

In Fiscal Year 1997, we activated new factories at Beaumont and Bryan, Texas; Forrest City, Arkansas; and Yazoo City, Mississippi; adding 1,100 additional inmate jobs. The increase in inmate jobs (6 percent) was directly in line with the overall inmate population growth. At year end, FPI employed over 18,400 inmates, 26 percent of the eligible population. The growth in the Bureau's inmate population over the next decade is projected to be relentless, and FPI will need to create additional inmate jobs and open new factories to keep pace.

We were also very encouraged by the updated results of the Post Release Employment

Project (PREP) study. This high quality longitudinal study has tracked several thousand inmates, some for as long as 12 years after release. The latest data continues to indicate that inmates who were involved in vocational training and prison industries while in custody were 20 percent more likely, even more than a decade after release, to be crime-free, employed and earning higher wages.

More Sales to Our Customers

For the first time in FPI's history, sales exceeded the \$500 million mark, with net sales for Fiscal Year 1997 at \$513 million. Despite this milestone, sales increased only 3 percent over Fiscal Year 1996, half as much as the inmate employment. This is partly attributable to FPI's continuing efforts to expand inmate employment in services, where more jobs are created through fewer sales dollars.

We were also pleased to be recognized by some of our customers for our performance. The Department of Justice hosted a "JUSTWORKS" awards ceremony to honor its employees who implemented programs that "cut red tape, put customers first, and get back to basics." FPI received a "JUSTWORKS" award for successfully implementing an initiative that saved the American taxpayers money and helped the federal procurement process work more efficiently. In partnership with the Defense Electronics Supply Center, FPI substantially streamlined the procurement of military parts from the Federal Correctional Institution (FCI) in Phoenix, Arizona. As a result of this initiative, deliveries that once took 288 days were reduced to an average of 15 days. Further, the initiative saved \$285,000 in the first year.

In addition, the FPI factory operation located at the FCI in Memphis, Tennessee, was recognized for its "superlative record of performance in support of the AEGIS sites activation process." AEGIS is an acronym for special systems and operations that the U.S. Navy developed to handle potential threats into the 21st Century. Since 1993, the FPI factory operation at FCI Memphis has assembled more than 4,000 cables to support many AEGIS

"In partnership, with UNICOR we strive to accommodate the customer in providing quality, selection and responsiveness throughout the upholstery fabric manufacturing process for its furniture products."

Mayer-Paetz Inc.

activation efforts and AEGIS Combat System elements. All cables were manufactured quickly and delivered on schedule with a 40 percent reduction in cost to the U.S. Navy.

More Purchases From Our Vendors

For every dollar of sales revenue FPI generates, seventy-three cents is used to purchase raw materials, supplies, equipment, machinery, and services from the private sector. For Fiscal Year 1997, FPI spent over \$300 million purchasing such items. Many of our vendors rely on FPI's purchases for their economic livelihood, and throughout this Annual Report, we highlight comments received from some of our vendors.

We are particularly pleased that, for the fifth year in a row, FPI was recognized by the Department of Justice for its purchases from small, women/minority owned, and disadvantaged firms. For Fiscal Year 1997, nearly 60 percent of FPI's purchases were made from these firms. This is an important national initiative that FPI is proud to support. It is widely recognized that small businesses generate more jobs per sales dollar than their large business counterparts. Through FPI's targeted procurement program, its purchases have a positive, compounding effect on the creation and support of jobs for law-abiding citizens.

More Initiatives to Improve Operations

This year, we developed more focus on and better measurement of timely deliveries to our customers. Using Fiscal Year 1997 as a running start, we established a goal of 98 percent on-time delivery in Fiscal Year 1998 (98 % in 98). From the date we established the goal, in January 1997, to the end of the fiscal year, on-time deliveries improved from 62 to 85 percent. We know that the higher the bar is set, the harder it becomes but we are determined to keep improving.

We also initiated the centralization of 110 general ledgers into one, the installation of new financial management reporting software, and the centralization of our collection and payment functions. These initiatives will

enhance our cash flow, the quality of our cost accounting and our financial interactions with our customers.

We are also very proud of the work we have done to make our products and services more environmentally friendly. We offer repair, refinishing, and refurbishing services to our customers which allow them to reuse such items as furniture, forklifts, vehicular components, mailbags, backpacks, and parachutes. We also repair surplus computers for donation to schools and disassemble old mattresses to keep them out of the waste stream. We use soy-based ink for printing, water-based finishes for furniture, and recycled milk containers for signs.

This year, the Bureau established the Inmate Placement Program Branch to sharpen our focus on improving an inmate's prospects for successful reintegration upon release. We have held job fairs in several prisons and have received commitments from several of FPI's vendors to hire released inmates. As the program takes hold throughout the Bureau, we expect to increase post-release employment success for inmates.

More Public Debate About FPI's Role and Impact

During Fiscal Year 1997, the public debate about how FPI should function and its potential adverse impact continued. The culmination was a debate in the U.S. Senate over legislation to eliminate FPI's mandatory source status. The amendment was defeated in favor of a study to address the procurement relationship between FPI and its principal customer, the Department of Defense. The study will be completed and forwarded to the Congress in Fiscal Year 1998.

There is virtually unanimous public support for the notions that inmates should be required to work (whether to learn skills or reduce idleness), that the adverse effect on the private sector of inmates working should be minimized and that the cost of operating prisons should be kept as low as practicable. The Board of Directors and the FPI staff do their very best to be responsive to the varied and conflicting demands associated with fulfilling each of these

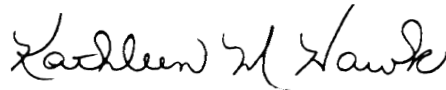
“We have formed a strong partnership with UNICOR over the past nine years, which has enabled us as a team to better meet the demands of the customer.”

OEI Division of Krueger International

priorities simultaneously. Likewise, we are very sensitive to the critics of FPI's operation. We do not shy away from the debate but will continue to insist that it consider the full range of intertwined issues, instead of only addressing the parochial interests of selected industries or companies.

There are no easy answers. There are, however, many questions which should be an integral part of the debate. Questions such as, “Is it acceptable for inmate labor to have any adverse impact on the private sector? If the impact is to be minimal, how should this be defined and measured, and by whom? Should

there be some means of compensating those who are impacted by inmate labor output? Should any adverse impact be offset by any demonstrated positive impact? What role should prison industries play in reducing recidivism? Should private industry be given certain incentives to utilize inmates in the production of their goods and services? If so, what markets should be accessible? What products or services are best for prison industries to focus on?” Suffice it to say, prison industries is a very complex public policy issue, which deserves a full, open and robust debate.



Kathleen M. Hawk
Director, Federal Bureau of Prisons
Chief Executive Officer, Federal Prison Industries

Report from the Ombudsman



Generally speaking, relations between FPI and the private sector were troubled during Fiscal Year 1997, primarily due to industry's mounting campaign for the wholesale elimination of FPI's mandatory source. Oddly, these efforts were initiated in the midst of a robust domestic economy, and in dramatic contrast with the supportive position taken by industry and labor in 1934 (the year FPI's mandatory source status was established), at a time when the country was recovering from the worst economic depression ever experienced.

Given this scenario, over the past year I concentrated my efforts on promoting an increased acceptance and understanding of FPI throughout corporate America. Presentations were conducted for companies across the country, with emphasis on clarifying FPI's programmatic responsibilities and dispelling numerous myths about waiver and other policies. I was encouraged by the positive feedback received. The majority of my audiences ultimately "got the message" that FPI is not a business per se, but rather, a vital component within the Bureau, utilizing business opportunities to achieve its corrections mission in a self-sustaining manner. Exploratory meetings were also held with prospective vendors intrigued with the idea of forging FPI partnerships to produce new products and services for sale to federal agencies. The level of interest expressed by a growing number of diverse companies is a healthy indicator that viable solutions can be found through joint ventures which, in turn, could advance the interests of all parties.

During Fiscal Year 1997, FPI received almost 12,000 waiver requests, representing

approximately \$302 million, and approved 83 percent, resulting in a \$251 million reallocation of potential FPI business to the private sector. Customers appealed 249 denied decisions estimated at \$22.5 million, of which 72 percent were overturned. Waiver approvals were primarily granted on the basis that FPI may not have been suitably postured to (1) meet customers' narrow delivery windows, (2) respond to unique, intricate technical specifications, or (3) effectively integrate its products within established, non-FPI configured facilities.

Environmental concerns surfaced as key factors in federal customers' purchasing decisions, specifically, whether FPI products were "environmentally preferable." Executive Order 12873, issued by President Clinton in 1993, mandated that the Federal Government take specific steps in becoming more environmentally friendly in the areas of acquisition, recycling, and waste prevention. Because interest in environmentally-conscious procurement practices continues to grow, I have been working closely with FPI and its contract vendors to encourage them to take all possible steps to ensure that environmentally sound processes will be evident throughout every phase of FPI's operations (marketing, production, packaging, and recycling) in support of the evolving procurement needs of its customers.

Looking forward to Fiscal Year 1998, I will continue to promote FPI's critical role as a correctional program, and remain sensitive to the need to minimize any negative impact of its operations on the private sector, be it in seeking partnering candidates, rendering appeal decisions, or searching for yet untapped solutions to marketplace complexities. Of course, I will continue to relay the concerns voiced by the private sector, labor, and federal agencies to FPI's Board of Directors and management during the challenging and promising times ahead.



Jan I. Hynson
Ombudsman

The New FPI Headquarters



Prior to Renovation

In 1996, FPI, with the assistance of the General Services Administration (GSA) and the Department of Justice, acquired the Railway Labor Building to renovate and use as its new Central Office headquarters building. The building is located in Washington, D.C., at 400 First Street, Northwest. Originally dedicated on March 31, 1960, the Railway Labor Building was once the Washington headquarters of the railway labor unions, as well as the home of the newspaper Labor.

After FPI's acquisition of the building, the GSA-approved renovation was initiated. In June 1997, FPI held a ceremony to rededicate the building, its new Central Office headquarters. During the ceremony, FPI officially changed the name of the building from the Railway Labor Building to the 400 First Street Building. Among those who attended the rededication ceremony were current and former members of FPI's Board of Directors, the Director of the Bureau (who is FPI's Chief Executive Officer), FPI's Chief Operating Officer, and other employees from the Bureau and FPI. At the conclusion of FPI's



After Renovation

rededication ceremony, a time capsule was enshrined in a wall in the lobby of the building to archive several historical FPI documents.

FPI's acquisition of the new headquarters was a sound financial decision for several important reasons. The acquisition terminated expensive rent payments that were required under former lease agreements. In addition, some of the space is occupied by other Bureau divisions who pay rent to FPI at rates considerably below what they previously paid. During the rededication ceremony in June 1997, the Bureau's Director Kathleen M. Hawk accentuated some of the financial advantages that resulted from FPI's acquisition of its new headquarters. Director Hawk stated that FPI's present and former Board members and its Chief Operating Officer "had the wisdom and foresight to recognize that purchasing a building was absolutely the right way to go for prison industries. It's a very clear example of good government." Director Hawk also stated, "The result of this purchase is going to be a significant savings to the taxpayer and is also going to be

“Our relationship with UNICOR has not just been one of ‘buyer and supplier,’ but one of a valued partnership where each works seamlessly together, focused on the single objective of customer satisfaction.”

Howard Industries Architectural Signage Systems

less overhead costs to prison industries.” She further stated, “This building will pay for itself in about nine years. I think that is extraordinary.”

In addition to providing space for offices, meetings, and in-house training, the new headquarters also provides excellent space for FPI’s showroom of products and services. Now, FPI’s customers can conveniently tour and shop for products and services with nearby assistance from FPI’s sales representatives.

Throughout the history of the Bureau and FPI, both component agencies have shared facilities and responsibilities that are associated

with their interrelated correctional missions. In keeping with this historical and strategic mode of operation, FPI shares its office space, meeting rooms, and in-house training facilities in the new headquarters with the Bureau. Previously, the Bureau was housed in six different buildings. As Director Hawk acclaimed, “Having us all in three buildings certainly increases the efficiency of operations.”

The financial investment in the new headquarters is an example of how Federal Prison Industries and the Federal Bureau of Prisons are continuing to be good public stewards.



Federal Bureau of Prisons’ Director Kathleen M. Hawk, (left to right) Federal Prison Industries’ Board of Directors, Chairman Joseph M. Aragon, Susan A. Loewenberg, Todd A. Weiler and Richard G. Womack participate in ribbon cutting rededication ceremony for the 400 First Street Building

FPI (UNICOR) National Award Recipients

FPI's ability to accomplish its mission and make a positive impact on our Nation's law enforcement efforts is possible only with the help of FPI's staff. Each year, FPI presents national awards to several employees for their extraordinary job performance and dedication. Below are summaries of each award category and the names of FPI's 1997 national award recipient(s) for each category.

has positively impacted the Corporation. Contributions can be in any area, such as administration, manufacturing, marketing, sales, institution relations, and/or external relations.



Steve Schwalb, Assistant Director, Industries, Education & Vocational Training (IE&VT) and Ginger Smith, Superintendent of Industries.

The Assistant Director's Award for Industries, Education, and Vocational Training recognizes on-the-job excellence among mid-level field and Central Office managers and supervisors who have broad executive or specific managerial responsibility, and who are accountable for a respective program area. Nominees must have demonstrated exemplary managerial and supervisory performance and/or significant contributions within the scope of program responsibilities.

Awarded to:
Ginger Smith, Superintendent of Industries
FCI Texarkana, Texas

The UNICOR Group Award for Excellence recognizes the UNICOR group of field or Central Office employees (program team, project team, unit, factory, business office, section, division, task force) whose contribution

Awarded to the Shared Services Team:
Federal Correctional Complex-Coleman, Florida
Jeanette Ayala, Industrial Manager
Mitchell Bagwell, Maintenance Mechanical Supervisor
Cynthia Beard, Accounting Technician
Melissa Beasley, Industrial Specialist
Cynthia Bloodworth, Woodworking Machine Operator Supervisor
Bernard Brown, Woodworking Machine Operator Supervisor
David Buggs, Jr., Industrial Specialist
Terry Carter, Production Controller
Nicholas Collins, Industrial Specialist
Rudi Cuevas, Materials Handler Supervisor
Mary Donovan, Quality Assurance Specialist
Larry Edwards, Woodworking Machine Operator Supervisor
Tommy Ellis, Materials Handler Supervisor
Bruce Green, Woodworking Machine Operator Supervisor

"FPI and LMT have developed joint manufacturing units that provide competitive storage products for the federal marketplace. Our engineering and production capabilities provide training for inmates and employment opportunities for workers at our facility..."

Lodi Metal Tech, Inc.

Cory Gysin, Materials Handler Supervisor
Daphne Harmon, Assistant Business Manager
William Hatton, Quality Assurance Manager
Eugene Howard, Woodworking Machine Operator Supervisor
Johnny Howard, Executive Associate Warden
Charles Johnson, Computer Specialist
Jeffrey Johnson, Upholstery Worker Supervisor
Paula Jordan, Factory Manager
Teddy Kennedy, Woodworking Machine Operator Supervisor
John Kroll, Upholstery Worker Supervisor
Kim McClendon, Accounting Technician
James Meany, Woodworking Machine Operator Supervisor
Bridgette Nickerson, Industrial Specialist
Terrence O'Brien, Operation Manager
Jeffrey Post, Woodworking Machine Operator Supervisor
David Pruiett, Production Controller
Norman Reid, Materials Handler Supervisor
Rebecca Reid, Contract Specialist
Salvador Rivera, Accountant
Juan Salgado-Maitin, Woodworking Machine Operator Supervisor
Jeffrey Schell, Traffic Management Specialist
Tad Schnaufer, Factory Manager
Barry Sheffield, Assistant Factory Manager
Leroy Simmons, Woodworking Machine Operator Supervisor
Carol Springer, Industrial Specialist
Gregory Stumbo, Industrial Manager
Charles Tackett, Woodworking Machine Operator Supervisor
Stanley Thompson, Materials Handler Supervisor
Gary Tosh, Woodworking Machine Operator Supervisor
Raymond Wiley, General Business Manager
Terry Winfrey, Assistant Factory Manager



Jeanette Ayala



Melissa Beasley



Cynthia Bloodworth



Bernard Brown



David Buggs, Jr.



Terry Carter



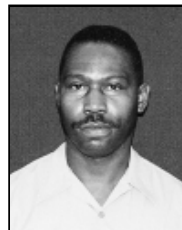
Nicholas Collins



Rudi Cuevas



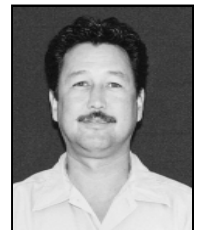
Mary Donovan



Larry Edwards



Tommy Ellis



Bruce Green



Cory Gysin



Daphne Harmon



Eugene Howard



Johnny Howard



Jeffrey Johnson



Paula Jordan

"As partners, UVEX Safety and UNICOR work together to maintain continuously high quality standards for both our eyewear products and our service to federal customers."

UVEX Safety



Teddy Kennedy



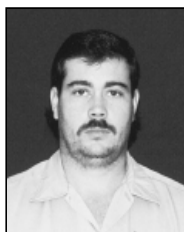
Kim McClendon



Bridgette Nickerson



Terrence O'Brien



Jeffrey Post



Norman Reid



Rebecca Reid



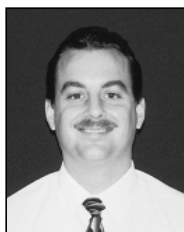
Salvador Rivera



Juan Salgado-Maitin



Jeffrey Schell



Tad Schnauffer



Barry Sheffield

The *UNICOR Individual Award for Central Office Excellence* recognizes one non-management/supervisory employee whose contribution has positively impacted the Corporation. Contributions can be in any area, such as administration, manufacturing, marketing, sales, institution relations, and/or external relations.

Awarded to:

Peter LaGuardia, Program Manager, Electronics Program
Central Office Headquarters-Washington, D.C.

The *UNICOR Individual Awards for Field Excellence* recognizes a maximum of six employees who have made significant contributions to the Corporation. Contributions can be in any area such as administration, manufacturing, marketing, sales, institution relations, and/or external relations.

Awarded to:

John Bade, Fabric Worker Supervisor,
FCI Sandstone, Minnesota
Wanda Green, Plant Controller,
FCI Lompoc, California
Steven Harrison, Factory Manager,
FCI Jesup, Georgia



Gregory Stumbo



Charles Tackett



Gary Tash



Raymond Wiley



Peter LaGuardia

"FPI's business relationship with SMC and its dedication to developing and providing contract opportunities for small disadvantaged businesses has contributed greatly to the success of our corporation."
Sioux Manufacturing Corporation



*John Bade
(center)*



Karen Robinson



Wanda Green



*Manuel Fierro
(center)*



Julie Kraemer



Laurie Farrall

Julie Kraemer, Systems Administrator,
USP Terre Haute, Indiana
Karen Robinson, Factory Manager,
FCI Fort Dix, New Jersey
Manuel Fierro, Brush Factory Manager,
FCI La Tuna, Texas



Robert Coffey

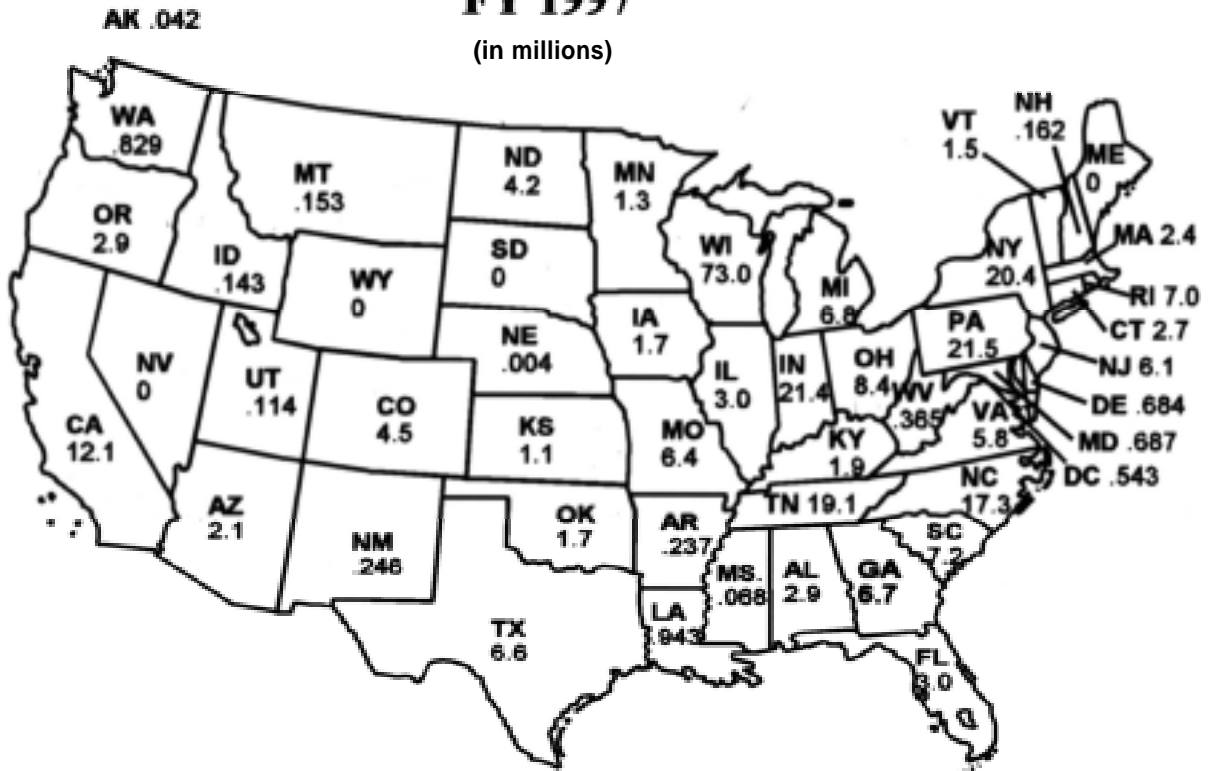
The *Excellence in Education, Recreation, and/or Vocational Training Award* recognizes a maximum of two employees in the Central Office and/or field Education, Recreation, or Vocational Training who have significantly contributed to the overall education, recreation, and/or vocational training goals of the Bureau.

Awarded to:
Laurie Farrall, Recreation Supervisor,
FPC Bryan, Texas
Robert Coffey, Supervisor of Education,
LSCI Allenwood, Pennsylvania

FPI Contracts Awarded to Private Sector

FY 1997

(in millions)



Alabama (AL)
\$2,869,000
• Montgomery
• Talladega
Alaska (AK)
\$42,000
Arizona (AZ)
\$2,087,000
•Phoenix
•Safford
•Tucson
Arkansas (AR)
\$237,000
•Forrest City
California (CA)
\$12,094,000
•Boron
•Dublin
•Lompoc
•Terminal Island
Colorado (CO)
\$4,528,000
•Englewood
•Florence
Connecticut (CT)
\$2,717,000
•Danbury
Delaware (DE)
\$684,000
Dist. of Columbia
(DC)
\$543,000
Florida (FL)
\$3,005,000

- Coleman
- Eglin
- Marianna
- Miami
- Tallahassee
- Georgia (GA)
- \$6,749,000
- Atlanta
- Jesup
- Hawaii (HI)
- \$0
- Idaho (ID)
- \$143,000
- Illinois (IL)
- \$3,033,000
- Greenville
- Marion
- Pekin
- Indiana (IN)
- \$21,410,000
- Terre Haute
- Iowa (IA)
- \$1,689,000
- Kansas (KS)
- \$1,082,000
- Leavenworth
- Kentucky (KY)
- \$1,857,000
- Ashland
- Lexington
- Manchester
- Louisiana (LA)
- \$943,000
- Oakdale
- Maine (ME)

\$0
 Maryland (MD)
 \$687,000
 • Cumberland
 Massachusetts
 (MA)
 \$2,360,000
 Michigan (MI)
 \$6,835,000
 • Milan
 Minnesota (MN)
 \$1,328,000
 • Rochester
 • Sandstone
 • Waseca
 Mississippi (MS)
 \$68,000
 • Yazoo City
 Missouri (MO)
 \$6,439,000
 Montana (MT)
 \$153,000
 Nebraska (NE)
 \$4,000
 Nevada (NV)
 \$0
 New Hampshire (NH)
 \$162,000
 New Jersey (NJ)
 \$6,059,000
 • Fairton
 • Fort Dix
 New Mexico (NM)
 \$246,000
 New York (NY)

- \$20,372,000
- Ray Brook
- North Carolina (NC)
- \$17,263,000
- Butner
- North Dakota (ND)
- \$4,182,000
- Ohio (OH)
- \$8,449,000
- Elkton
- Oklahoma (OK)
- \$1,716,000
- El Reno
- Oregon (OR)
- \$2,886,000
- Sheridan
- Pennsylvania (PA)
- \$21,526,000
- Allenwood
- Lewisburg
- Loretto
- McKean
- Schuylkill
- Rhode Island (RI)
- \$7,011,000
- South Carolina (SC)
- \$7,195,000
- Estill
- South Dakota (SD)
- \$0
- Tennessee (TN)
- \$19,100,000
- Memphis
- Texas (TX)

- Bishop
- Beaumont
- Big Spring
- Bryan
- El Paso
- Fort Worth
- La Tuna
- Seagoville
- Texarkana
- Three Rivers

Utah (UT)
\$114,000

Vermont (VT)
\$1,467,000

Virginia (VA)
\$5,848,000

- Petersburg

Washington (WA)
\$829,000

West Virginia (WV)
\$365,000

- Alderson
- Beckley
- Morgantown

Wisconsin (WI)
\$72,981,000

Wyoming (WY)
\$0

Legend
\$ Dollar Amount of Contracts
Awarded in FY1997

- FPI Locations

Industrial Programs
Locations, Inmate Employment, and Net Sales
As of September 1997
(Dollars in Thousands)

(Dollars in Thousands)				
Textiles	Electronics	Furniture	Metals	Graphics /Service
<ul style="list-style-type: none"> •Alderson WV •Atlanta, GA •Bastrop, TX •Beaumont, TX •Bryan, Tx •Butner, NC •Dublin CA •Fort Dix, NJ •Greenville, IL •Jesup, GA •Leavenworth, KS •Manchester, KY •Miami, FL •Oakdale, LA •Otisville, NY •Ray Brook, NY •Safford, AZ •Sandstone, MN •Seagoville, TX •Terre Haute, IN •Tucson, AZ •Yazoo City, MS 	<ul style="list-style-type: none"> •Beaumont, TX •Big Spring, TX •Boron, CA •Danbury, CT •Estill, SC •Fairton, NJ •Lexington, KY •Lompoc, CA •Loretto, PA •Marion, IL •Memphis, TN •Oxford, WI •Petersburg, VA •Phoenix, AZ •Rochester, MN •Three Rivers, TX 	<ul style="list-style-type: none"> •Allenwood, PA •Ashland, KY •Beckley, WV •Florence, CO •Forrest City, AR •Leavenworth, KS •Lompoc, CA •Marianne, FL •Sheridan, OR •Talladega, AL •Tallahassee, FL •Texarkana TX •Three Rivers, TX 	<ul style="list-style-type: none"> •Coleman, FL •El Reno, OK •Lewisburg, PA •McKean, PA •Milan, MI •Morgantown, WV •Pekin, IL •Schuylkill, PA •Terminal Island, CA 	<ul style="list-style-type: none"> •Bastrop, TX •Butner, NC •Cumberland, MD •Dublin CA •Eglin, FL •El Paso, TX •Fort Dix, NJ •Fort Worth, TX •La Tuna, TX •Leavenworth, KS •Lexington, KY •Lompoc, CA •Marianne, FL •Montgomery, AL •Petersburg, VA •Sandstone, MN
Inmates Employed:†				
5,083	3,275	3,410	2,813	2,105
Net Sales:				
\$112,069.00	\$ 111,987.00	\$ 124,132.00	\$120,971.00	\$43,737.00

Some locations have multiple plants.

†‡The total number of inmates employed by Federal Prison Industries as of **September** 1997 was 18,414. This includes 1,728 inmates employed in support positions.

Financial Statements

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Report of Management

Responsibility for the integrity and objectivity of the financial information in this report rests with the management of Federal Prison Industries, Inc. The accompanying financial statements have been prepared to conform with generally accepted accounting principles.

To ensure the integrity of financial data, FPI management maintains a system of internal accounting controls. The system provides reasonable assurance that transactions have management authorization and are properly recorded. It also safeguards, verifies, and maintains accountability of assets and permits preparation of financial statements that conform with generally accepted accounting principles. This system of internal controls is subject to periodic reviews by both management and FPI's independent auditors.

Internal accounting and administrative control systems have been reviewed and tested. Accordingly, FPI management provides the following assurances:

1. There are sufficient controls and security measures to compensate for any identified risks associated with the program/system and/or its environment,
2. The program/system is being operated in an effective manner and complies with applicable laws and regulations,
3. There is proper management of the program/system information, and
4. The program/system complies with management, financial, information resources management, accounting, budget and other appropriate standards.

The independent auditing firm of Urbach Kahn & Werlin PC is retained to audit FPI's financial statements. The role of independent auditors is to provide an objective review of management's responsibilities to fairly report operating results, cash flows and financial position. The independent auditor's reports are presented on the following pages. The report on the fairness of the presentation of the financial statements is unqualified.

The independent auditor obtains an understanding of FPI's internal control structure sufficient to plan the audit and to determine the nature, timing, and extent of tests to be performed to form an opinion on the fairness of the presentation of the financial statements.

Although management may periodically adopt certain cost-effective recommendations made by the independent auditors to further strengthen FPI's system of internal controls, management believes that FPI's internal and accounting control system is accomplishing its objectives.

Kathleen M. Hawk
Director, Federal Bureau of Prisons
Chief Executive Officer, Federal Prison Industries

Independent Auditor's Report on the Financial Statements

Office of the Inspector General
United States Department of Justice

Board of Directors
Federal Prison Industries, Inc.

We have audited the accompanying statements of financial position of Federal Prison Industries, Inc. (FPI) as of September 30, 1997 and 1996, and the related statements of operations and cumulative results of operations, and cash flows for the years then ended. These financial statements are the responsibility of FPI's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards; **Government Auditing Standards** issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 93-06, **Audit Requirements for Federal Financial Statements**. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FPI as of September 30, 1997 and 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with **Government Auditing Standards**, we have also issued a report dated December 5, 1997 on our consideration of FPI's internal control structure and a report, also dated December 5, 1997, on its compliance with laws and regulations.

URBACH/KAHN & WERLIN/PC

Washington, DC
December 5, 1997

Independent Auditor's Report on Internal Control Structure

Office of the Inspector General
United States Department of Justice

Board of Directors
Federal Prison Industries, Inc.

We have audited the financial statements of Federal Prison Industries, Inc. (FPI) as of and for the year ended September 30, 1997, and have issued our report thereon dated December 5, 1997.

We conducted our audit in accordance with generally accepted auditing standards; **Government Auditing Standards** issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 93-06, **Audit Requirements for Federal Financial Statements**. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of FPI is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit of the financial statements of FPI for the year ended September 30, 1997, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, including those policies and procedures designed to determine that data which supports reported performance measures in the "1997 Annual Report" are properly recorded and accounted for to permit preparation of reliable and complete performance information. We assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the specific internal control structure elements does not reduce, to a relatively low level, the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited or material to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control structure and its operation that we consider to be material weaknesses as defined above.

Independent Auditor's Report on Internal Control Structure, Continued

We did, however, note other matters involving the internal control structure and its operation that we have reported to the management of FPI.

This report is intended for the information of the Office of the Inspector General, United States Department of Justice, and the Board of Directors and management of FPI. However, this report is a matter of public record and its distribution is not limited.

URBACH KAHN & WERLIN PC

Washington, DC
December 5, 1997



Urbach Kahn & Werlin PC
CERTIFIED PUBLIC ACCOUNTANTS

**Independent Auditor's Report
on Compliance with Laws and Regulations**

Office of the Inspector General
United States Department of Justice

Board of Directors
Federal Prison Industries, Inc

We have audited the financial statements of Federal Prison Industries, Inc. (FPI) as of and for the year ended September 30, 1997, and have issued our report thereon dated December 5, 1997. We conducted our audit in accordance with generally accepted auditing standards; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*, as amended.

The management of FPI is responsible for complying with applicable laws and regulations. As part of obtaining reasonable assurance about whether FPI's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts, and certain other laws and regulations specified in OMB Bulletin 93-06, as amended, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996.

The results of our tests of compliance disclosed no instances of noncompliance with the laws and regulations discussed in the preceding paragraph.

Under FFMIA, we are required to report whether FPI's financial management systems substantially comply with the Federal financial management systems requirements, applicable accounting standards, and the United States Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance using the implementation guidance for FFMIA issued by OMB on September 9, 1997.

The results of our tests disclosed no instances where FPI's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph.

Providing an opinion on compliance with certain provisions of laws and regulations was not an objective of our audit and, accordingly, we do not express such an opinion.

This report is intended for the information of the Office of the Inspector General, United States Department of Justice, and the Board of Directors and management of (FPI) However, this report is a matter of public record and its distribution is not limited.

Washington, DC
December 5, 1997

GOVERNMENT AUDIT AND CONSULTING GROUP
1444 Eye Street NW, Washington, DC 20005 (202) 296-2020 FAX (202) 223-8488
Worldwide Coverage through Urbach Hacker Young International

Federal Prison Industries, Inc.

Statements of Financial Position

September 30

(DOLLARS IN THOUSANDS)

1997

1996

Assets

Current:

Cash and cash equivalents	\$ 98,735	\$ 92,600
Accounts receivable, net	69,098	61,087
Inventories, net	83,009	87,149
Other current assets	3,645	2,017

254,487 242,853

Property and equipment, net

149,095 140,246

\$403,582 \$383,099

Liabilities and U.S. Government Equity

Current:

Accounts payable	\$ 37,053	\$ 31,390
Customer and other advances	48,264	42,232
Accrued salaries and wages	7,987	6,867
Accrued annual leave	6,345	6,048
Other accrued expenses	10,758	6,452

110,407 92,989

Loan payable to U.S. Treasury

20,000 20,000

Total liabilities

130,407 112,989

U.S. Government Equity

Initial capital	4,176	4,176
Donated property	861	909
Cumulative results of operations	268,138	265,025

273,175 270,110

\$403,582 \$383,099

See notes to financial statements.

Federal Prison Industries, Inc.

Statements of Operations and Cumulative Results of Operations

<i>Years Ended September 30</i>		
<i>(DOLLARS IN THOUSANDS)</i>	1997	1996
Net sales	\$512,896	\$495,466
Other income	12,138	4,814
Total income	525,034	500,280
Cost of goods and services sold	476,587	452,058
Gross profit	48,447	48,222
Selling and administrative expenses	45,334	36,087
Net income	3,113	12,135
Cumulative results of operations, beginning of year	265,025	252,890
Cumulative results of operations, end of year	\$268,138	\$265,025

See notes to financial statements.

Federal Prison Industries, Inc.

Statements of Cash Flows

<i>Years Ended September 30</i>		
<i>(DOLLARS IN THOUSANDS)</i>	<i>1997</i>	<i>1996</i>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	\$544,437	\$540,036
Cash paid to suppliers	(384,635)	(379,404)
Civilian and inmate payrolls	(139,229)	(132,242)
Interest income	3,237	2,638
Net cash provided by operating activities	23,810	31,028
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of machinery and equipment	(7,417)	(2,914)
Construction of buildings and improvements	(10,258)	(10,601)
Cash used in investing activities	(17,675)	(13,515)
Net increase in cash and cash equivalents	6,135	17,513
Cash and cash equivalents, beginning of year	92,600	75,087
Cash and cash equivalents, end of year	\$ 98,735	\$ 92,600
SCHEDULE RECONCILING NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net income	\$ 3,113	\$ 12,135
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	10,036	9,392
Accrual of annual leave	297	450
Net (gain) on disposals of assets	(6,773)	(3,495)
Changes in:		
Accounts receivable	(8,011)	3,362
Inventories	4,140	1,323
Other current assets	(1,628)	(1,025)
Accounts payable	5,663	4,376
Customer and other advances	6,032	1,183
Accrued salaries and wages	1,120	450
Other accrued expenses	4,306	2,877
Net cash provided by operating activities	\$ 18,295	\$ 31,028

See notes to financial statements.

Note 1.

Organization and Mission

Federal Prison Industries, Inc. (FPI) was established in 1934 by an act of Congress. FPI operates under the trade name UNICOR, as a wholly-owned federal government corporation within the United States Department of Justice, and functions under the direction and control of a six member Board of Directors. The members, appointed by the President, represent retailers and consumers, agriculture, industry, labor, the Attorney General, and the Secretary of Defense. FPI's statutory mandate is to provide employment and training for inmates in the federal prison system while remaining self-sufficient through the sale of its products and services.

FPI's customers consist exclusively of federal government departments and agencies, such as the Department of Defense, General Services Administration and the Department of Veterans Affairs. These and other federal organizations are required to purchase products from FPI, if its products meet the customers' price, quality, and delivery standards, under a mandatory source preference specified in FPI's enabling statute and the Federal Acquisition Regulation.

At September 30, 1997, FPI had industrial operations at 97 factories located at 63 facilities within the federal prison system. FPI's factories employed approximately 18,400 inmates at September 30, 1997, representing approximately 18.2% of the total federal inmate population.

Note 2.

Summary of Significant Accounting Policies

Financial Statement Presentation - The accompanying financial statements, which are prepared on the basis of generally accepted accounting principles, include each of FPI's industrial facilities located throughout the federal prison system and FPI's central administrative offices. All significant interfacility and interfactory transactions, including profits, have been eliminated for financial reporting purposes.

Cash and Cash Equivalents - Cash and cash equivalents are comprised of cash and short-term repurchase agreements with the U.S. Department of Treasury. The market value of the repurchase agreements is equivalent to cost. Interest income approximated \$3,237,000 and \$2,638,000 during the fiscal years ended September 30, 1997 and 1996, respectively. Certain portions of FPI's cash and cash equivalent balances have been internally restricted to provide a sinking fund for future loan repayments (see Note 5) and to fund future purchases of inventory related to customer advances.

Accounts Receivable - Accounts receivable consist of amounts due from federal government departments and agencies. Accounts receivable, as presented in the statements of financial position, are stated net of an allowance for doubtful accounts in the amounts of \$1,202,000 and \$1,693,000 at September 30, 1997 and 1996, respectively.

Note 2.
Summary of Significant
Accounting Policies,
Continued

Accounting for Contracts A portion of FPI's sales are made under contracts using a percentage of completion method of accounting. FPI determines sales and gross profits based upon a unit of shipment basis. General and administrative costs are recognized as incurred. Revisions in estimated profits are made in the period in which the circumstances requiring the revision become known. Provisions are made currently for anticipated losses on uncompleted contracts.

Inventories - FPI's inventories, which are comprised of raw materials, work in process and finished goods, are stated at the lower of cost or market value, using the weighted average method. The recorded amounts are periodically adjusted for the results of physical inventories. Work-in-process and finished goods inventories include the cost of raw materials, direct labor and production overhead. FPI records an inventory allowance account to reflect estimated losses for inventories which may not be utilized in the future and anticipated inventory losses for contracts where the current estimated cost to manufacture the item exceeds the total sales price. Inventories, as presented in the statements of financial position, are stated net of such allowances in the approximate amounts of \$4,428,000 and \$3,054,000 at September 30, 1997 and 1996, respectively.

Property and Equipment - As more fully disclosed under Note 4, property and equipment, including significant improvements to existing facilities, are stated at cost, net of an allowance for accumulated depreciation. Repairs and maintenance costs are expensed as incurred. The straight-line method of depreciation is utilized to allocate the cost of property and equipment over their estimated useful lives, which range between 5 and 40 years.

Customer and Other Advances - FPI receives customer cash advances on certain contracts to fund significant raw material purchases. The unexpended portion of these advances approximated \$48,264,000 and \$39,732,000 at September 30, 1997 and 1996, respectively. At September 30, 1996, customer and other advances also included \$2,500,000 received from the Federal Bureau of Prisons relating to future lease payments (see Note 4).

Accrued Leave: Annual and compensatory leave is recorded as an expense, with an offsetting liability, as it is earned by FPI's employees. The liability is reduced as leave is taken. Each year, the balance in the accrued annual leave liability account is adjusted to reflect current pay rates. Sick leave and other types of nonvested leave are recognized when taken.

Taxes - As a wholly-owned corporation of the federal government, FPI is exempt from federal and state income taxes, gross receipts tax, and property taxes.

Reclassifications - Certain 1996 financial statement line items have been reclassified to conform with the current year's presentation.

Notes to Principal Financial Statements

Note 3.
Inventories

Inventories are comprised of the following:

<i>September 30</i> (DOLLARS IN THOUSANDS)	1997	1996
Raw materials	\$ 49,592	\$ 54,580
Work-in-process	22,115	23,172
Finished goods	15,730	12,451
	87,437	90,203
Less inventory allowance (Note 2)	4,428	3,054
	\$ 83,009	\$ 87,149

Note 4.
Property and
Equipment

Property and equipment is comprised of the following:

<i>September 30</i> (DOLLARS IN THOUSANDS)	1997	1996
Machinery and equipment	\$ 86,092	\$ 77,023
Buildings and improvements	160,706	142,056
	246,798	219,079
Less accumulated depreciation	99,267	91,613
	147,531	127,466
Construction in progress	1,566	12,780
	\$149, 097	\$140,246

Property and equipment is carried at cost, net of accumulated depreciation. Donated property and equipment, which is recorded at fair value at the date of donation, principally relates to property and equipment transferred from the Bureau of Prisons and other Federal government sources. Included in property and equipment are non-operating facilities and equipment with a book value of approximately \$2,575,900 and \$2,123,700 as of September 30, 1997 and 1996, respectively, which are being held for sale or other disposition.

Depreciation expense approximated \$10,036,000 and \$9,392,000 for the years ended September 30, 1997 and 1996, respectively.

Note 4.
Property and
Equipment,
Continued

During the current year, FPI completed the renovation of a building purchased in 1996 for use as its Washington, DC based central administrative offices. At September 30, 1996, FPI had paid approximately \$9.6 million of the contract amount and these amounts were included in construction in progress as of that date. The balance of the contract, which was funded from operating cash and a \$2.5 million advance from BOP, was paid upon completion of the construction in 1997.

Note 5.
Loan Payable to
U. S. Treasury

Congress has granted FPI borrowing authority pursuant to Public Law 100-690. Under this authority, during fiscal year 1989, FPI borrowed \$20,000,000 from the U.S. Department of Treasury with an original lump-sum maturity or optional renegotiation date of September 30, 1998. The funds received under this loan were utilized in the construction of factories and the purchase of equipment. The loan accrues interest, payable March 31 and September 30 of each year, at 9.125% (the rate equivalent to the yield of U.S. Treasury obligations of comparable maturities which existed on the date of the loan). Accrued interest payable under the loan is either fully or partially offset to the extent FPI maintains non-interest bearing cash deposits with the U.S. Treasury. In this regard, there is no accrual of interest unless FPI's cash balance on deposit with Treasury falls below \$20,000,000. When this occurs, interest is calculated on the difference between the loan amount (\$20,000,000) and FPI's cash balance. The cash balance on hand at Treasury may differ from the cash balance in the statement of financial position due primarily to vouchers in transit.

The loan agreement provides for certain restrictive covenants and a prepayment penalty for debt retirements prior to 1998. Additionally, the agreement limits authorized borrowings in an aggregate amount not to exceed 25% of FPI's net equity.

During 1995, the Treasury approved FPI's request to extend the loan maturity date to September 30, 2008 at a rate to be determined in 1998.

There was no interest expense for the years ended September 30, 1997 and 1996.

Notes to Principal Financial Statements

Note 6.**Product Sales
Information**

FPI's operations consist of five principal product programs. Sales information for the years ended September 30, 1997 and 1996 follows:

Net Sales		
(DOLLARS IN THOUSANDS)	1997	1996
Product Programs		
Metals	\$120,971	\$116,884
Furniture	124,132	116,424
Electronics/Plastics	111,987	106,998
Graphics/Services/Optics	43,737	43,737
Clothing/Textile	112,069	111,423
	\$512,896	\$495,466

Note 7.**Intragovernmental
Financial Activities**

FPI's financial activities interact with and are dependent upon those of the Federal government as a whole. The following is a discussion of certain intergovernmental activities and their related interaction with FPI:

Relationship with the Federal Bureau of Prisons: FPI and the Federal Bureau of Prisons (BOP) have a unique relationship in that the nature of their respective missions requires the sharing of facilities and responsibilities relative to the custody, training and employment of federal inmates. The Director of the BOP serves as the Chief Executive Officer of FPI and the Chief Operating Officer of FPI serves as an Assistant Director of the BOP. The BOP provides land to FPI for the construction of its manufacturing facilities and both FPI and BOP share certain facilities, generally at no cost to FPI.

Self Insurance: In accordance with federal government policy, FPI is uninsured with respect to property damage, product liability, and other customary business loss exposures. Losses incurred are absorbed as a current operating expense or, if they are induced by factors related to FPI's relationship with the prison system, may be reimbursed by BOP. Certain other costs, principally relating to personal injury claims, are paid directly by the federal government.

Federal Employees Compensation Act: The Federal Employees Compensation Act (FECA) provides income and medical cost protection to federal civilian employees injured on the job, employees who have incurred a work-related occupational disease, and beneficiaries of employees whose death is attributable to a job related injury or occupational disease. The U.S. Department of Labor (DOL), which administers FECA, annually charges each federal department and agency for its applicable portion of claims and benefits paid in the preceding year. During the fiscal years ended September 30, 1997 and 1996, such claims and benefits, as charged to FPI, approximated \$266,000 and \$408,000, respectively.

Note 7.
Intragovernmental
Financial Activities,
Continued

DOL also calculates the liability of the federal government for future claims and benefits, which includes the estimated liability for death, disability, medical, and other approved costs. Future claims and benefits are determined from an actuarial extrapolation, utilizing historical benefit payment patterns and calculations of projected future benefit payments discounted to current value over a 23.5 year period. FPI's estimated future liability, which is included with other accrued expenses, approximated \$2,850,000 and \$2,261,000 at September 30, 1997 and 1996, respectively.

Retirement: Substantially all of FPI's civilian employees are covered under either the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). For employees covered under CSRS (those employees hired prior to January 1, 1984), FPI withholds approximately 7 percent (for normal retirement) or 7.5 percent (for hazardous duty retirement) of each employee's salary and contributes a matching amount to the fund. CSRS covered employees do not have Federal Insurance Contributions Act (FICA) withholdings and, thus, are not fully eligible to receive Social Security benefits. For employees covered under FERS (generally those employees hired on or after January 1, 1984), FPI withholds, in addition to FICA withholdings, approximately 1.3 percent of employee gross earnings, and matches such withholdings with a 7 percent contribution.

Under FERS, employees also receive retirement benefits from Social Security and, if applicable, benefits from a defined contribution plan (thrift). Under the thrift plan, an employee may contribute (tax deferred) up to 10 percent of salary to an investment fund. FPI then matches this amount up to 5 percent. Those employees which elected to remain under CSRS after January 1, 1984 continue to receive benefits in place, and may also contribute (tax deferred) up to 5 percent of their salary to the thrift plan, but with no matching amount contributed by FPI.

CSRS and FERS are multiemployer plans. Although FPI funds a portion of pension benefits relating to its employees, and provides for the necessary payroll withholdings, it does not maintain or report information with respect to the assets of the plans, nor does it report actuarial data with respect to accumulated plan benefits or the pension liability relative to its employees. The reporting of such amounts is the responsibility of the U.S. Office of Personnel Management.

FPI's contribution to both plans was approximately \$14,554,184 and \$16,683,000 for the years ended September 30, 1997 and 1996, respectively.

In addition, beginning in the current fiscal year, under SFFAS # 5, Accounting for Liabilities of the Federal Government, FPI was required to recognize its share of the true cost of providing pension benefits to eligible employees utilizing cost factors determined by the Office of Personnel Management. SFFAS # 5 had the effect of increasing pension expense, a component of selling and administrative expense, by approximately \$2,680,000 in the current fiscal year with an offsetting credit to other income. The comparative true cost of providing pension benefits was not recorded in the prior fiscal year. However, because of the offsetting credit, the recording of these costs had no impact on net income in either 1997 or 1996.

Note 7.

In trago vernmen tal
Financial Activities,
Continued

Health Benefits and Life Insurance: FPI, through the Office of Personnel Management (OPM), offers health and life insurance plans under which premium costs for health care are shared between FPI and the employees. A substantial portion of life insurance premiums are paid for by employees. Amounts paid by FPI for health benefits were approximately \$4,441,000 and \$4,431,000 for the years ended September 30, 1997 and 1996.

OPM also provides health care and life insurance benefits for FPI's retired employees. Beginning in the current fiscal year, under SFFAS # 5, FPI was required to recognize as an expense its share of the cost of such post retirement health benefits and life insurance on a current basis (while its employees are still working), with an offsetting credit to other income. Current year costs in this regard, which approximated \$3,619,000, were determined by OPM utilizing cost factors which estimated the cost of providing post retirement benefits to current employees. The comparative cost of post retirement benefits was not recorded in the prior fiscal year. However, because of the offsetting credit, the recording of these costs had no impact on net income in either 1997 or 1996.

Future post retirement health care and life insurance benefit costs are not reflected as a liability on FPI's financial statements as such costs are expected to be funded by OPM.

Note 8.

Commitments and
Contingencies

Lease Commitments: FPI has various operating lease agreements for certain of its facilities, including its central administrative offices in Washington, DC. Under these agreements, total rent expense amounted to approximately \$1,407,000 and \$1,804,000 in the fiscal years ended September 30, 1997 and 1996, respectively. In addition, FPI leases certain equipment, both in Washington and at industrial facilities throughout the prison system, under operating leases which expire over extended periods of time. Many of these operating leases provide FPI with the option (after an initial lease term) to either purchase the equipment at the then fair value or to renew the lease for additional periods of time. Future commitments under all of these lease arrangements are not significant.

Planned Construction: At September 30, 1997, various projects were in progress for the construction of new industrial facilities and the renovation of existing facilities. In this regard, BOP, on behalf of FPI, is planning to invest approximately \$14,400,000 during the next three years for the construction of buildings and improvements. In addition, during the next three years, FPI is planning to invest approximately \$45,000,000 for the purchase of machinery and equipment, and for the continued implementation of a new computer system.

Notes to Principal Financial Statements

Note 8.

Commitments and
Contingencies,
Continued

Congressional Limitation on Administrative Expenses: Congress places an annual spending limit on certain administrative costs relating to FPI's central office (Washington, DC) management. These costs include salaries for management personnel, travel expenses and supplies. The following is a comparison of actual expenses to the limitation for the years ended September 30, 1997 and 1996:

Applicable Administrative Expenses

(DOLLARS IN THOUSANDS)

	1997	1996
Congressional limitation on expenses	\$3,740	\$3,559
Expenses incurred subject to Congressional limitation	\$1,679	\$1,794